

Message Text

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PAGE 01 OTTAWA 02198 131544Z

53

ACTION EB-11

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TAGS: EFIN, CA

SUBJECT: BANK RATE AND PRICES RISE AGAIN

1. BANK OF CANADA GOVERNOR GERALD K. BOUEY ANNOUNCED EVENING OF SEPTEMBER 12 THAT BANK RATE BEING INCREASED FROM 6.75 PERCENT TO 7.25 PERCENT. LATEST INCREASE IS FIFTH IN AS MANY MONTHS AND PLACES BANK RATE 2.5 PERCENTAGE POINTS HIGHER THAN IT WAS FIVE MONTHS AGO. THE MOVE FOLLOWED BY A MATTER OF HOURS THE ANNOUNCEMENT BY SEVERAL CHARTERED BANKS THAT PRIME RATES WERE BEING HIKED BY 75 BASIS POINTS TO A RECORD NINE PERCENT EFFECTIVE SEPTEMBER 17. PRIME RATES HAVE BEEN INCREASED SIX TIMES SO FAR THIS YEAR AND NOW STAND 50 PERCENT HIGHER THAN EARLY APRIL LEVELS.

2. IN PRESS STATEMENT, BOUEY NOTED PRESSURES IN FINANCIAL MARKETS WHICH LED TO FURTHER INCREASES IN SHORT-TERM RATES, INCLUDING THE PRIME RATE INCREASE ANNOUNCED EARLIER IN THE DAY, AND STATED: "THE UPWARD PRESSURE ON CANADIAN SHORT-TERM INTEREST RATES HAS COME NOT ONLY FROM THE STRONG DEMAND FOR CREDIT IN CANADA BUT ALSO FROM THE MUCH HIGHER LEVELS OF SHORT-
UNCLASSIFIED

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PAGE 02 OTTAWA 02198 131544Z

TERM INTEREST RATES IN MANY OTHER COUNTRIES WHICH, LIKE

CANADA, HAVE BEEN EXPERIENCING RAPID GROWTH IN EMPLOYMENT AND OUTPUT, HEAVY CREDIT DEMANDS AND EXTRAORDINARILY LARGE PRICE INCREASES. IN THE UNITED STATES INTEREST RATES BEING PAID BY BANKS ON SHORT-TERM DEPOSITS HAVE RECENTLY BEEN 10 TO 11 PER CENT, IN THE EURO-DOLLAR MARKET THEY HAVE BEEN 11 TO 12 PER CENT, AND IN BRITAIN AND GERMANY THEY HAVE BEEN EVEN HIGHER. THE EXTENT TO WHICH SHORT-TERM INTEREST RATES IN CANADA CAN BE MAINTAINED AT LOWER LEVELS THAN RATES IN OTHER MAJOR COUNTRIES IS LIMITED BY THE FACT THAT CANADIAN FINANCIAL MARKETS ARE CLOSELY INTERCONNECTED WITH FINANCIAL MARKETS ABROAD, AND SUBSTANTIAL INTEREST RATE DIFFERENTIALS THEREFORE TEND TO GENERATE INTERNATIONAL FLOWS OF FUNDS WHICH ADD TO THE PRESSURE OF DEMAND IN DOMESTIC CREDIT MARKETS AND IN THE FOREIGN EXCHANGE MARKET." THE PRESS RELEASE ADDED: "THE GOVERNOR EMPHASIZED THAT THE POLICY OF THE BANK OF CANADA CONTINUED TO BE DIRECTED TOWARDS MODERATING THE UNUSUALLY RAPID GROWTH OF BANK CREDIT AND MONEY IN CANADA WHILE STILL LEAVING AMPLE SCOPE FOR MONETARY GROWTH ADEQUATE TO SUPPORT CONTINUED EXPANSION OF EMPLOYMENT AND OUTPUT."

3. PRESENT ROUND OF INCREASES HAS BEEN EXPECTED FOR SEVERAL WEEKS. RISING U.S. RATES HAVE RESULTED IN WIDENING OF INTEREST RATE DIFFERENTIAL WITH CONSEQUENT SOUTHERLY FLOW OF SHORT-TERM FUNDS, STRENGTHENING OF U.S. DOLLAR ON CANADIAN EXCHANGE MARKETS AND LOSS OF 268 MILLION U.S. DOLLAR RESERVES IN PAST TWO MONTHS. SPOT RATE OF C\$1.0098 ON SEPT. 11 MARKED FIRMEST CLOSING IN TWO YEARS. EXCHANGE MARKET REACTION TO CHARTERED BANK ANNOUNCEMENT WAS IMMEDIATE AND DOLLAR WEAKENED SIGNIFICANTLY, CLOSING AT C\$1.0078 SEPT 12.

4. BANK RATE INCREASE ALSO COMES AT TIME OF MAJOR PUBLIC CONCERN ABOUT INFLATION. COST OF LIVING STATISTICS RELEASED THIS MORNING SHOW CPI ROSE BY 1.3 PERCENT DURING AGUST AND BY 8.3 PERCENT OVER A YEAR AGO. FOOD PRICES WERE UP BY 3.2 PERCENT FOR THE MONTH AND 15.8 PERCENT OVER A YEAR AGO. EXCLUDING UNCLASSIFIED

UNCLASSIFIED

PAGE 03 OTTAWA 02198 131544Z

FOOD, THE TWELVE MONTH CPI INCREASE WAS 5.4 PERCENT. THE DATA REFLECT PRICES AT THEIR LATE JULY-EARLY AUGUST PEAKS AND THERE EVIDENCE OF SOFTENING SINCE THEN. RECENT ANNOUNCEMENT OF ANTI-INFLATION MEASURES (OTTAWA 2105) AND BANK RATE HIKE SHOULD REDUCE PRICE RISES BUT GOC WILL REMAIN UNDER PRESSURE FROM OPPOSITION PARTIES IN PARLIAMENT TO TAKE FURTHER STEPS. SCHMIDT

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